RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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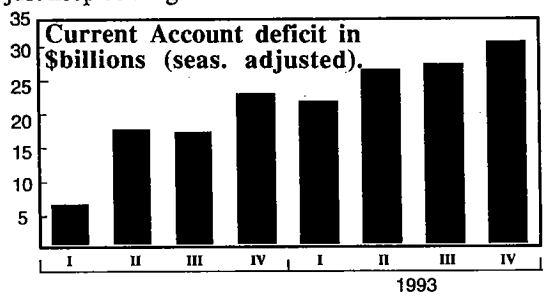
26 Letters Per Year • $250 annually

May 25, 1994 **LETTER 1148**

THE PICTURE -- THE DOLLAR: The Achilles heel of the markets is the dollar. In the last Letter I discussed the dollar and the problems that the weak dollar has been creating for ALL the markets (stocks, bonds, commodities). I want to start this Letter with a further discussion of the dollar, because the dollar's problems impact on almost every area of finance and the economy at this time.

For three years interest rates were forced artificially lower by the Fed, a Fed frantic to stimulate the sluggish US economy. One result of the Fed's manipulations was a reliquefying of the banks and a ballooning of their reserves. To put it bluntly -- the banks have been "saved."

But there are other problems beside the banks' problems that must be addressed. One is the US current account balance (involving all trade in goods and services), which has deteriorated in 23 of the last 24 months. This has resulted in tens of billions of dollars spewing out over the rest of the world. The virtual avalanche of dollars has forced foreign individuals, corporations and central banks to absorb a large portion of these dollars. And yet -- the dollars just keep coming.



Too much of any commodity (whether it's copper, oil or Italian pasta) will drive the price down. Which is exactly what's been happening to the dollar. But wait -- the dollar is the world's reserve currency; every central bank counts dollars as part of its official reserves. Which means that the central banks can not allow the dollar to go "down the tubes." Furthermore, a cheap dollar gives US exports a decided advantage over foreign exports. So let the dollar cave in? No way, the central banks cannot allow it to happen.

So the central banks have been forced to intervene -- to buy dollars in order to "hold up" or "stabilize" the greenback. Now if a central bank buys another nation's currency, it has to create more of its own currency in order to buy that other currency -- and this process is highly inflationary.

The artificially low US interest rates, the negative US current account balances, and the weak dollar, all resulted in one phenomenon -- they resulted in the US exporting its inflation abroad.

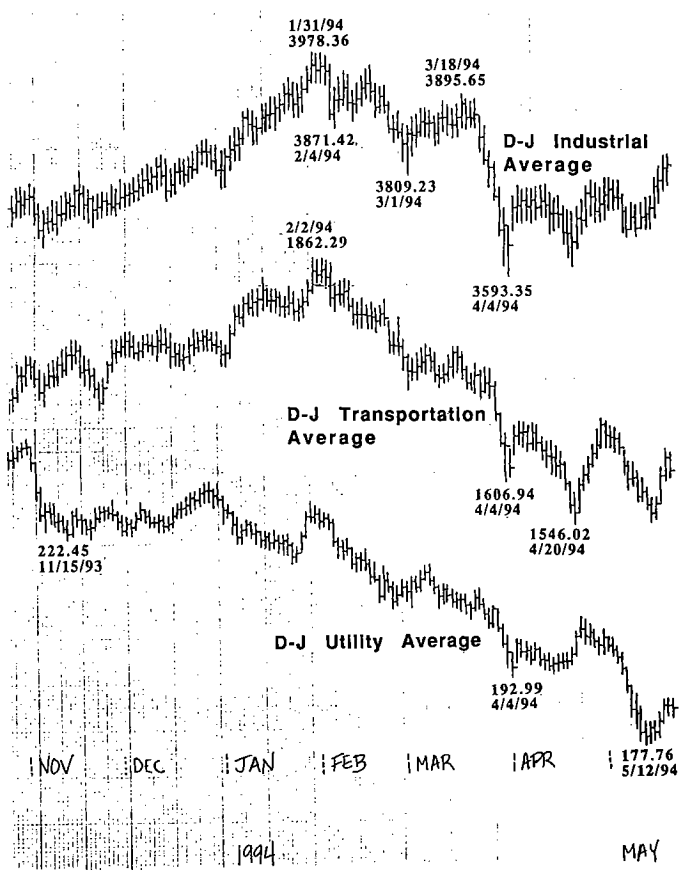
On May 17 the Fed (in a belated effort to take pressure off the dollar) boosted the discount rate 1/2% and raised the Fed Funds rate to 4.25%. Despite the rate increases, the dollar continued on the weak side. The Fed, having just raised rates, cannot (for political reasons) raise rates again. Ah, the perfect situation for the hedge funds and FOREX traders to attack the dollar (for an update, see Late Notes, page 6).

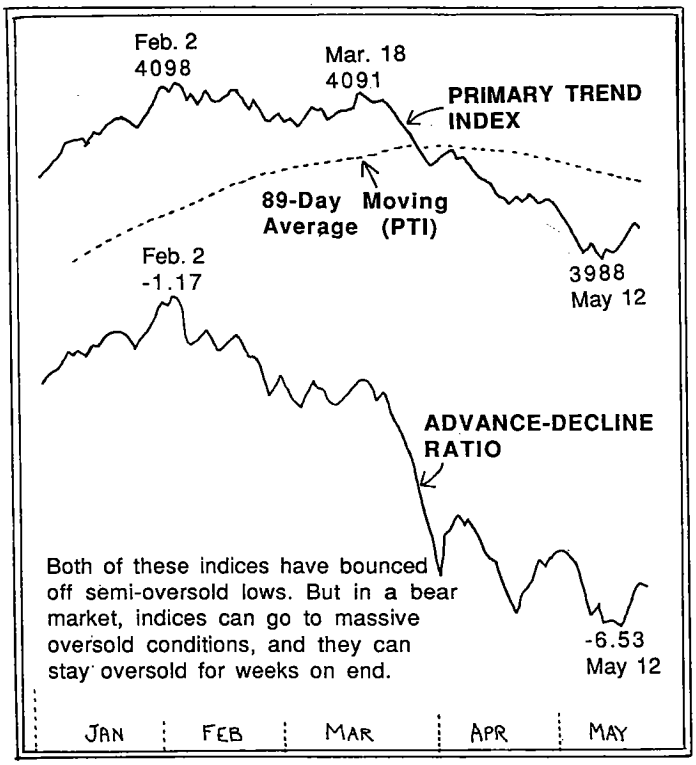
May 13 DJIA 3659.68; PTI 3992; A-D Ratio -6.45
May 20 DJIA 3766.35; PTI 4003; A-D Ratio -5.90
Dow Yield: 2.69%; Dow Price/Earnings: 25.7
Dow 200-day MA: 3724; Dow 30-day MA: 3679
Dow Times Book Value: 3.28; PTI 89-day MA: 4035
Percentage of Undervalued Blue-chips: 12%
Dow Low Risk Buy Index: -50; Gold-PTI: 963
Gold 40-week MA: 377

This whole situation brings up a number of questions: (1) Will the FOREX (foreign exchange) traders attack the dollar again? (2) If they do, will the Fed have the guts to raise rates a fifth time, this time high enough to actually support the dollar? (3) If the Fed raises rates substantially, how severely would it impact on the stock and bond markets and the economy? (4) What happens if foreigners simply refuse to absorb more dollars? In that case, would we be facing a dollar collapse?

Questions, questions, but in the meantime one thing is certain -- the US is continuing to run large current account deficits, meaning that foreign investors or foreign central banks will be forced to absorb more dollars (the US dollar outflow is running at the rate of around $10 to $12 billion a month). To absorb all these dollars and at the same time support the dollar will mean continuing inflation pressures overseas. The alternative, as I said before, would be the Fed instituting a serious, major upward thrust in US interest rates.

The picture, as it stands now, is for a concerted rise in inflation both here and overseas. But haven't we been told almost daily by economists and by the Fed and the administration that there's no inflation in sight? We have, indeed, but it looks as though the Fed and the economists and the administration are going to be wrong.





Some evidence: Columbia University's inflation model has now risen seven months in a row and is at its highest level in a decade. The barometric CRB Raw Materials Index is at its highest level in years. The *Journal of Commerce's* Index of Spot Commodities is just a fraction from a four year high. Home prices are moving up across most of the US. Copper prices (an excellent inflation barometer) are at a five year high, crude oil has risen to around $18 a barrel, up almost 30% from this year's low. GM has boosted prices on the hot-selling Chevy Camaro and Pontiac Firebird for the second time this year. Japanese car prices are rising. Gem prices at auction (*Christie's* and *Sotheby's*) are very firm. Gold and silver appear to have bottomed and have moved well off their lows.

Conclusion: I'd be very surprised if the hedge fund traders and the FOREX traders did not again "test" the Fed's resolve regarding defending the dollar. A test would mean another attack on the dollar. So watch the currencies and the bonds. If the bonds sense another attack and still higher rates, they will head down (this is no time to own bonds).

As I said at the start of this section, the dollar is the key, and right now the dollar is reflecting 40 years of US mismanagement plus the socialistic bent of the current administration.

THE MARKETS: After 36 years in this business, I've developed a few rules of my own. One is, ***"Don't listen to the words, listen to the music."*** The words are the news, the advice of experts, the rumors, the inside information, the forecasts, the opinions. The music is the action of the markets.

All right, let's listen to some music; but first I want to say something to new subscribers. I want to repeat that the market isn't interested in today's news and it's not interested in yesterday's news. No, the function of the stock market is to look ahead, to discount conditions as they will be six months or even a year from now.

Remember, if you read it in the newspaper, if you saw it on CNBC, if you heard on the radio -- it's history. What you're reading and hearing are facts and statistics that have already happened. But the stock market is only interested in what's going to happen, not what happened today, this week, last week or a month ago.

The D-J Industrial Average hit its bull market peak on January 31 at 3978.36. By April 4 the Dow had declined to 3593.35, a decline (on a closing basis) of 385 points or 9.7%. The D-J Transportation Average struck its bull market high on February 2 at 1862.29. By April 20 the Transports had declined to 1546.02, a decline of 323 points or 17%. The Utility Average hit its bull market high back on September 13 at 256.46. By May 9 the Utility Average closed at a low of 177.76, a loss of 79 points or a fat 31%.

These percentages represent costly bear market losses. But by my reckoning the bear market is still in its first psychological phase. I say this because sentiment towards the market is still quite hopeful, and there exists a large body of opinion that holds that this is just a long overdue correction rather than a primary bear market.

I want to cite this up as an example of the market's prescience, its foresightedness. The Utility Average topped out last September 13. Now, eight months later, the news is finally emerging, news to justify the costly bear market in utilities. Rates are rising, impacting the interest rate sensitive utilities, FPL just cut its dividend by one third (frightening the whole industry), and now private competition is clearly threatening the utilities. The lesson -- never think that you know more than the market. If you do, nine times out of 10 you'll be wrong.

Remember, I said in the last Letter that the bull will not die easily. The bull has been master of the stock market ever since 1974, and he's not about to flop over and give up the ghost overnight. No, he's going to fight the trend with all the energy and power at his command. Furthermore, the bull will have the help of the administration, the world's central banks, thousands of fund managers, and a public that continues to pump huge amounts of money into the markets (to a large extent via the mutual funds).

Technically, the market has been somewhat oversold, and it has been trying to rally. But the rally, so far, has been of poor quality. The Dow has been rising, but my Primary Trend Index has resisted following. The advance-decline ratio has been registering new lows, and many stocks have been recording new 52-week lows. So despite the fact that the Dow has been rallying, the market action has been suspect. The bear, it seems, has been toying with the bottom-fishers and optimistic buyers. "C'mon in," says the bear, "the water's fine."

The Advance-Decline Ratio broke to a new bear market low as recently as May 16, but the early April lows on both the Industrials and Transports have held (see page 1 chart). The series of new lows in the A-D ratio and in the PTI tell us that the "underbelly" of the market is weak, that the market as a whole has been hemorrhaging. But the refusal of the Dow and the Transports to break to fresh bear market lows suggests that the market wants to rally. The rally, so far, has been technically poor, but it has, nevertheless, moved the Averages higher and has rekindled the hopes of the bulls.

Comment: I had a long talk last week with my old friend, Marty Zweig. Marty and I have watched a lot of bull and bear markets. Marty is afraid that this bear market could be a long drawn-out, frustrating affair lasting maybe five years or longer. Said Marty, "It could be one of those situations where you have mini-bull and bear markets over an extended period of time, and where nothing is easy and nobody makes money." Russell comment: I won't argue with that. And so far, this year, I don't know anyone who's become rich via the market.

In his mid-May report, Joe Granville states flatly that the Dow will be at the 2000 level by the first quarter of 1995. Russell comment: Never write off a Joe Granville prediction, particularly if it sounds outlandish.

No, no, please, not you Elaine!!

By Dan Dorfman
USA TODAY

Elaine Garzarelli, Wall Street's most influential stock market bull, may be entering the bear's den. The Lehman Bros. market strategist is said to be privately telling some friends to sell stocks.

INVESTMENT POSITION: The bear is in the box. He threatens to be around for quite a while. So let's keep it simple. The place to be is cash. What kind of cash? T-bills, money market funds, even muni money market funds. Continue to accumulate gold coins and continue to hold your gold stocks. Now that S. Africa has enjoyed a peaceful (amazing) election and now that it has a democratic, mixed-race (amazing) government, the premium for Krugerrands (premium for the coins over actual gold content) is rising, meaning that the Krugies will be increasingly accepted and in demand throughout the world.

STRESS: If you are holding a stock on margin (or any negotiable item), you face two levels of risk during a bear market. The first level occurs when your item goes down, but you own the item outright. The second level of risk is when your item goes down, but you are on margin.

When you own the item outright, you can't lose it unless the item itself goes bankrupt. In other words, if you own Exxon in a bear market, and it goes from 61 to 30, the decline will prove highly stressful, but the ultimate risk is limited, since it is hard to envision Exxon going broke, and it is hard to see the next bull market in force without taking Exxon back (at worst) at least a fair distance towards the highs. True, it's gut-wrenching seeing your stock lose half its value, but it's not the end of the world.

However, if you own a new issue stock called Wonkonics on 50% margin, and your stock heads down, brother, that's real stress. Furthermore, the latest report is that the president of Wonkonics has disappeared, and now there's a good chance that Wonkonics will be part of stock market history. Because you own 5,000 shares of this puppy, you find yourself sleeping about an hour-and-a-half a night.

From my own experience, I find that it's not worth putting myself in a position where I face a good chance of experiencing major stress. That means that, personally, I don't buy stocks on margin. I don't sell short. Furthermore, if I don't sell stocks when they drop below a pre-determined level that also bothers me. Probably the best test (and it's a time-honored test) is this -- would you still buy the stock today that you are holding? If you definitely would not buy it, it's probably a good idea to give it back to Wall Street.

Why do I emphasize avoiding stress? Answer: because it's definitely within our power to avoid most stress, because accepting stress when you can avoid it is a form of self-torture, and because in some cases stress can take months or years off your life.

In the April issue of the *Harvard Heart Letter,* published by the Harvard Medical School, they ask the question, *"Does Stress Shorten Lives?"* The *Letter* then quotes from a long-term Swedish stress study involving 752 50-year old men. The study found that "the risk of dying more than tripled if the men were divorced or separated from their wives or were in serious financial trouble during the years prior to the initial evaluation. The risk increased 7.7-fold if the person had been sued. Feelings of insecurity at work were associated with a 2.4-fold increase in death-risk. Overall, three or more stressful life events more than tripled the risk of dying. The conclusion was that *"psychological stress can have long-term medical implications and should not be ignored."*

Russell comment: There are some stressful events that you cannot escape such as divorce or a death in the family or losing one's job. There are others that you can avoid, and in investing you can avoid potential major stress by not leveraging and not letting yourself be locked into major losses.

A primary bear market almost always leads to losses, and that's why I advise subscribers to get liquid during the very early stages of a bear market. Moving to the sidelines may look wrong for a while, but before the bear market is over you will find that watching the show from the sidelines allows you to avoid a great deal of stress. And in avoiding stress, you will probably add months or years to your life.

NOTES & QUOTES: The London *Economist* is probably the most international and most important magazine (as far as opinion-forming) of any publication. Here's what the *Economist* says about the Clinton situation:

> BILL CLINTON stars in an anti-crime advertisement that has been showing on television and in cinemas in the United States. At one point, he puts his hands on the shoulders of a young black woman and says that Americans can make the streets safe if they work together. Watching the president lay his hands on someone of the opposite sex, audiences have started to snigger. This is part of the Paula Jones effect.
>
> The effect is greater than many people care to admit. Even an America that has overdosed on the bizarre tales of Lorena Bobbitt and Tonya Harding finds Paula Jones's accusation of sexual harassment by the man who is now president of the United States pretty powerful stuff. Some pooh-pooh its significance, others pretend it is beneath their dignity to take any interest. The truth is that everyone is gripped.

* *

The bear market is beginning to take its toll -- both domestically and internationally. Here are how a few world markets have done (the following figures pertain to a few major markets and the percentage declines from their bull market highs): Australia down 12.7%; Austria down 39%; Britain down 12%; Canada down 7%; France down 8.3%; Italy down 12.3%; Japan down 49%; Spain down 11.4%; Switzerland down 13.3%; US down 6.6% (statistics from the *Economist*).

* *

Dan Rostenkowski is not one of my favorite guys, but give him his due, he's saying Clinton is wrong on his health care program; he's saying that the program will cost up to $40 billion a year, and that to institute the program taxes will have to be raised. The fact is that literally every government program ends up as inefficient, and every program ends up costing more than was first calculated. Ah, Social Security, what a sad mess that's turned out to be (particularly for people under 35). This cartoon probably says it all:

WE ARE GOING TO FIX SOCIAL SECURITY BY INCREASING PAYROLL TAXES, CUTTING BENEFITS AND RAISING RETIREMENT AGE TO 67.
THIS SHOULD KEEP THE SYSTEM HEALTHY UNTIL 2030.
or two years, whichever comes sooner.
WE'RE INCREASING PAYROLL TAXES AGAIN, CUTTING BENEFITS AND RAISING RETIREMENT AGE TO 70, WHICH SHOULD KEEP THE SYSTEM HEALTHY UNTIL 2050.
or two years, whichever comes sooner.
...AND RAISING RETIREMENT AGE TO 92, WHICH SHOULD KEEP THE SYSTEM HEALTHY UNTIL 2075.
or your death, whichever comes sooner.
THEIR NEW SLOGAN: 'DON'T WAIT UP FOR ME.'

* *

With all the inane talk and effete non-policy regarding Haiti, columnist William Safire has come up with the first really intelligent suggestion. The plan -- a Haiti "Bay of Pigs," but this time get it right. There are 200,000 Haitians here in the US. Give Haitian volunteers basic training and more, and let them take back their own country. Writes Safire, US trained "Haitians would have a proud, fierce, battle ready unit -- better equipped and trained than Haiti's. Then you put them on US warships, backed by an aircraft carrier loaded with helicopter gunships, sail into Port-au-Prince -- and see what effect all that has on the band of hoodlums on the dock who chased us away." Russell comment: Sounds like a plan to me. Is anyone listening?

* *

The dollar is still (yes still) the world's reserve currency. Basically, every other currency is measured in terms of the dollar (although hard-money people may prefer to measure their currencies against gold). At any rate, it's fascinating to study the "World Value of the Dollar" list that appears in the *WSJ*. The dollar value of over 200 countries' currencies are listed, and the list includes such exotic currencies as Bangladesh Taka, the Burma Kyat, the Ethiopian Birr-o, the Fiji dollar, the Haiti Gourde, the Tonga Islands Pa'anga, the Ukraine Karbovanet, and the Zambia Kwacha -- all measured against the dollar.

* *

The dollars our government is printing via their high-speed presses are due for a new look. According to *USA Today,* a new counterfeit proof bill is in the hopper. The Treasury will start with $100 bills (they are the ones drug dealers favor). The new bills will have a much larger portrait way over to the right or left, the bills will be multi-colored (so when copied two colors will produce a third color), they will contain a watermark that can not easily be erased, and they will have the little metallic ribbon running through the paper (actually, it's not paper, it's a mixture of cotton and linen).

* *

If you've been worrying about Hong Kong and the 1997 takeover by China, you can worry less. Why? China's rulers and their sons and daughters are moving closer to Hong Kong's business elite. Hong Kong represents a chance for China's ruling class to get rich, and they're taking advantage of the opportunity. The number of Hong Kong companies controlled by Chinese state-owned companies has moved up from 200 two years ago to the current 1,000. Yep, the Chinese want to do business in Hong Kong, and they want to own businesses in Hong Kong. In the end, economics always wins.

* *

Make money in commodities? It isn't easy. According to *Futures* magazine, of 231 reporting companies so far in 1994, 45 were showing profits and 184 were registering losses, while 2 were unchanged. Average performance for the year -- minus 6.1%, and these are professionals.

* *

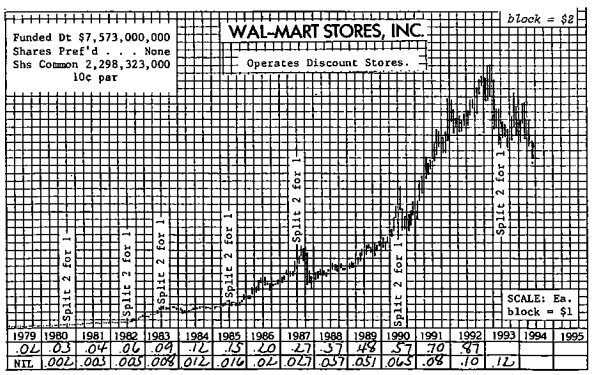
Amazing: Last week sprinter Carl Lewis ran the second fastest (10.04 seconds) 100-meter dash in the world this year. Amazing because Lewis is now aged 32 . . . Dan "Big Daddy" Wilkenson, first round draft choice of the NFL's Cincinnati Bengals, won the contest as the strongest man on the team. Big Daddy bench-pressed 275 pounds -- ahem, not once but 23 times. Said an awed teammate, "Frightening, he's going to destroy somebody."

* *

Inflation Anyone? The cost of a four-year college degree has finally passed the (gulp) $100,000 mark. Yale freshman will pay $26,350 for tuition, room and board, and Harvard frosh will pay only $120 less. MIT will charge $26,075, Brown is $25,954, Swathmore is $25,900 and Stanford is a bargain at $25,465.

* *

Mighty Wal-Mart: The stock may be well down from its high of just over 34, but sales are booming. With sales of over $60 billion, WMT has surpassed sales of K-Mart and Sears combined. WMT's sales are now as big as the sales of all US department stores taken together. Despite this, the stock appears to be in a huge head-and-shoulders top.



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Our government probably won't stop so-called "gun control" until they disarm all honest citizens. As for where America's kids get their guns from, here's the story from the *American Institute of Justice*: 38% of kids get guns from a friend, 23% get a gun from a family member, 14% get a gun off the street, 14% get a gun from an addict/dealer or from a stolen source, and only 11% buy a gun from a gun shop. In other words, 89% of the kids get a gun from a source other than a legitimate gun dealer. Gun control -- it amounts to making it difficult for honest people to buy guns. The criminals can get all the guns they want.

* *

And speaking of weapons, many question why the World Bank is lending billions of dollars to poor nations who spend unconscionable amounts on arms. Example: India's central government spent 17% of its budget on its military and only 4% on health and education; Pakistan 27% and 2.6%; Syria 31.5% ands 9.3%. When you analyze it, most of the military expenditures are to insure the safety of the people in power. Oh yes, the biggest seller of arms is the good old USA. ("Hey, If you've got the money, we've got the merchandise.")

* *

In business, women are finally beginning to come into their own. Of three million new businesses established in the US over the past five years, more than half were started by women. Largest of the women-owned business are Gymboree Corp. (sales $650 million), The Body Shop ($625 million), The ASK Group ($483 mils.), Copley Pharmaceuticals ($445 mils.), Carole Little ($300 mils.), DKNY ($250 mils.), USA Network ($200 mils.), Systemix ($178 mils.).

* *

Is TV as we know it doomed? Could be, and the new kid on the block is the computer and more specifically the PC. With all the talk of "500 TV channels," it seems that for interactive applications it's the computer that will win the war. Very soon (some of it here now) you will be able to log into movies, videos, games, news, shopping, encyclopedia information, travel information, sports tickets, theater, etc., all via your home PC. The Russell opinion -- the future lies with computers, not with TV.

A few weeks ago I signed up for *America Online,* and although it's not fascinating yet (except for the interactive conversations with people from all over the nation), it's well worth having. And the Internet will be getting better rapidly. And yes, computer ignoramus that I am, I can even work the computer, logging in and logging out of programs and picking out areas that I want to get into.

* *

I've received numerous letters from subscribers regarding EDTA chelation and how it's been going for me. I've already taken 20 sessions of these intravenous treatment. Then my kidneys got a bit "over-worked," and the Doc told me to hold off for a month before resuming any further sessions, but I start this week again. The concept is that chelation (pronounced key-lation) clears out the capillaries and veins and thus allows these clogged vessels to bring more blood to the heart. During the chelation sessions I've heard many fabulous personal stories from people (not hearsay) who had been unable to walk, who had suffered from severe angina, etc., and who are now in fair to good shape again (many swear that they have been spared bypass operations and amputation). If you're interested in learning more about chelation, I suggest you read one of the numerous books on the subject (they're available from most health food stores). Few if any doctors will recommend chelation, and insurance companies won't pay for the sessions. From what I've seen, chelation is one of the great unspoken secrets of medicine. Why doesn't the American Heart Association fund a "double-blind" study to determine its effectiveness? Three possible reasons: (1) "Double-blind" studies are very expensive, and the FDA doesn't do these studies; (2) EDTA has been around a long time; it's not a patented drug, so no drug company is interested in promoting it; (3) if they discovered that chelation works and that it may help avoid surgery, the news would bankrupt half the hospitals in the nation (many hospitals survive on their income from surgery). As for me, I note that I can go longer and faster on my treadmill and that I feel generally better and have more energy. EDTA chelation -- the forbidden secret. And the supreme irony -- insurance companies would rather shell out $50,000 for a bypass

operation than even investigate the possible benefits of chelatior Go figure. Insurance executive subscribers (and I have a lot of you), please drop me a line if you have any comments.

* *

The FDA's wanted the power to demand that all vitamins and supplements show "significant" scientific agreement before claiming that a particular vitamin or supplement can prevent or cure a disease. But tens of thousands of consumers, fearing that this was a step towards barring many supplements, wrote to their Congressmen and Senators protesting the latest FDA power-grab. Result: the Hatch bill delaying any new labeling laws for three years. Russell comment: Thank you, Senator Hatch. Let's keep the government's hands out of vitamins and supplements.

* *

The *Economist* runs their annual Big MacCurrency test to determine how much over or under a hamburger costs in various currencies. Since a Big Mac is now literally universal, here's how the numbers came out in the various currencies (figures show whether a currency is overvalued or undervalued in purchasing power vs. the dollar): Australia -25%; Belgium +35%; Brazil -31%; Britain +15%; Canada -10%; China -55%; France +38%; Germany +17%; Hong Kong -48%; Italy +21%; Japan +64%; Mexico +5%; Russian -29%; Spain +9%; Sweden +39%; Switzerland +72%. Conclusion: if you want a lot for you buck, stay out of France and Switzerland and instead visit Hong Kong or Brazil.

* *

What's the biggest growth industry in the US? Probably crime. Get these figures: in 1965 the justice system employed 600,000 people. In 1993 it employed two million. In 1965 the criminal justice system cost taxpayers $4.6 billion or 0.6% of the entire GDP. By 1993 the cost had risen to roughly $100 billion or 1.57% of the GDP.

* *

Trading Places: The tide could be turning (positive) for Republicans. In the Senate Georgia's Coverdell defeated Dem. incumbent Fowler. In Texas (Senate) Repub. Bailey defeated Dem. Krueger. In the House Oklahoma's Repub. Lucas defeated Dem. Webber to fill a vacant house seat. Governors: New Jersey Repub. defeated Dem. Allen, and in Virginia Repub. Allen defeated Dem. Wilder. In Arkansas GOP Huckabee defeated Dem. Tucker for Lt. Governor, succeeding Bill Clinton. Mayors: in LA, NYC and Jersey City Repubs. defeated Dem. mayors.

* *

I'll admit it, I read *Premier* and *Entertainment Weekly* and *People* and I often watch the Entertainment channel. Furthermore, I have a 13-year old daughter who reads *National Enquirer* and *Star*, and I have another daughter who's an actress. Frankly, I'm thoroughly keyed into Hollywood. So what's going on? Drew Barrymore is divorcing Jeremy Thomas after a two-month marriage. Julia Roberts is leaving Lyle Lovett after a few months of marital bliss. Roseanne has filed for divorce from Tom Arnold for the second time in a month. Melanie Griffith and Don Johnson are on and off on their marriage. Christie Brinkley and Billy Joel have called it quits. And Paula Abdul and Emilio Estevez are now saying bye-bye. And gee -- Barbra Streisand has put up boutiques at her concerts and is selling $400 sweaters with her name on it. As *Entertainment Weekly* asks, "Don't her initials say enough?"

* *

One out of four Americans still smokes, but teenagers are increasing their smoking and listen to this -- smoking now kills more women than breast cancer, car accidents, fires, AIDS, alcohol, suicide and drugs combined. The big tobacco companies are worried about the anti-smoking sentiment in the US so they are moving their action and attention full blast to Asia. In Asia, a large majority of Asian men smoke and the women are picking up the habit fast. I smoked for years, 18 to 40, and I wish I had every day I smoked back again. It's an addiction, it's insidious, it's deadly, and if you're still doing it -- my advice -- stop. Mike, are you listening?

* *

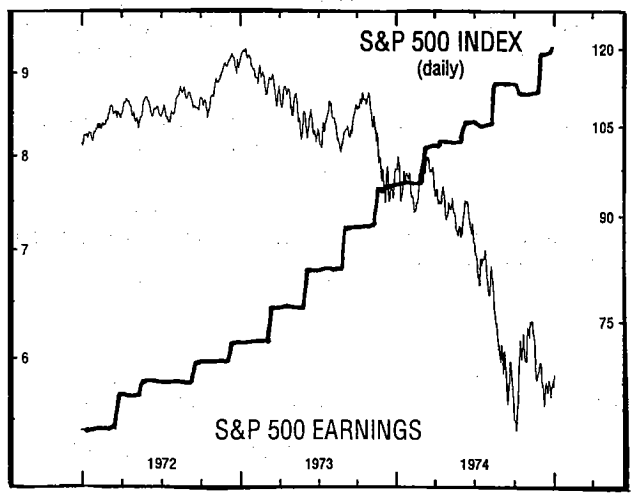
I doubt if burgers are good for you, but McDonald's now sells 'em in 71 countries -- about 28 million a day, or about one billion burgers a week. Me, I'm turning more vegetarian all the time.

* *

Question -- who's the scariest woman in America? Easy, it's Tonya Rodham Bobbitt.

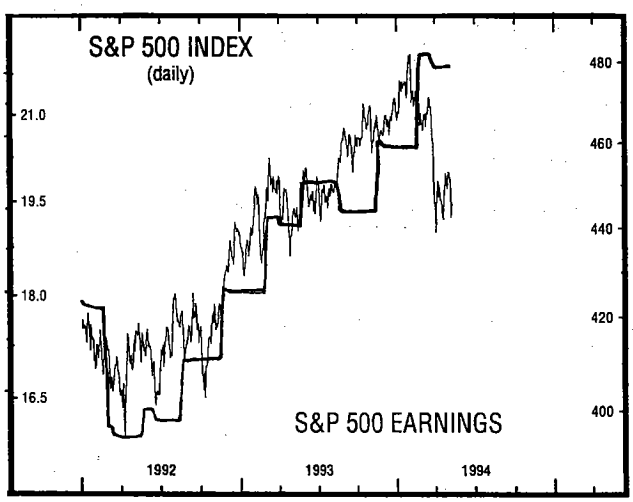
* *

In a previous Letter I described *Market Logic's* "Bad news-good news" index. This index of dividend boosts or cuts is based on case history which shows that when "bad news" (i.e., stocks cutting dividends) is emerging, the market tends to rise, since the market has already discounted the bad news and is looking forward to better times. Conversely, when "good news" (i.e., corporations raising dividends) is emerging, as now, the market tends to go down, because the market has already discounted the "bad news" and is looking forward to a rosier scenario when dividends will be increased.



Confirming this paradox, I just got a letter from John "Computer Man" Carder, and he sends me dramatic charts showing the S&P 500 and the earnings momentum during the great 1972-74 bear market. Writes John, "If you look at the 1972-74 bear market, you'll notice that earnings momentum peaked as price momentum was bottoming. That decline was *only* 48% in the face of rising earnings." The second chart shows the current situation -- 1992-94. Check it out.

Conclusion: Analysts and economists who tell you that "there can't be a bear market because earnings and dividends are rising" -- don't know what they are talking about. When attempting to predict the trend of the stock market, nothing is more deceptive than the trend of earnings and dividends. This is true because the stock market discounts, it often moves six to 18 months ahead of the news.



GOLD: Up to now weakness in the dollar has prompted the "big boys" (hedge funds, FOREX traders, etc.) to move out of the greenback and into the yen, the D-mark, the Swissie and even the pound. But my feeling is that the attack (or let's call it hedging) against the dollar is now beginning to spread out into the area of gold, gems, commodities and tangibles in general (maybe even real estate). If the dollar is riding the

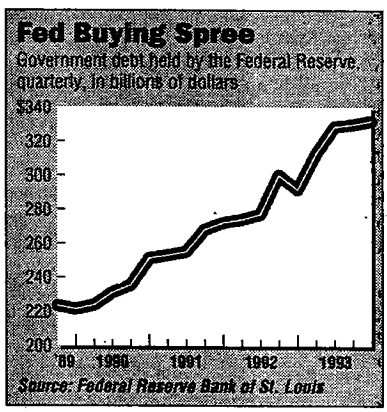
down-escalator, you don't want to be in paper, you want to be in real items, tangible items.

Personally, I bought another batch of Krugerrands last week. Listen, I don't care what anyone says, there's something about real, honest-to-goodness, physical gold that differs from anything else in the financial world. You hold the coins in your hand, and you tell yourself, "This is real wealth, this is real money. It's tangible money, money that will ALWAYS possess purchasing power." The stock market can collapse, bonds can go belly-up, commodities can dump, your house can burn down -- but gold, it's true value, it's immutable, it's anonymous, and it's out-lasted a thousand paper currencies. Gold has been called money since the times of the pharaohs and before. Gold is the first metal mentioned in the Bible. A hundred years from now, when all of today's paper money is in frames on the walls of monetary museums, gold will still represent purchasing power. I worry about a lot of things, but I never worry about physical gold.

Isn't it marvelous -- our government can run its high-speed machines 24 hours a day and print "wealth." And a miracle! The newly-printed paper is accepted as money. Of course, it's not permanent wealth, and that's the problem. Today a hundred dollar bill will buy maybe 70 hamburgers. Give your kid a hundred dollar bill -- tell him to save it to the year 2020, then take it out and see how many burgers it will buy. Maybe it'll buy 30, maybe 10, maybe only one, who knows. Listen, it could be he'll starve on a hundred dollar bill by the time the year 2020 comes around.

Meanwhile, it's clear that the Fed is now targeting interest rates to gold. It's also clear that the Fed does not want gold over 400 and probably not over 385. We, who own gold, must face it -- gold and the natural market forces are aligned against the full manipulative power of the Fed.

What's the Fed doing besides watching gold? It's buying bills, notes and bonds hand over fist. This little chart appeared in the May 16 *WSJ*. When the Fed buys paper, it's increasing the reserves of the banks. And when the banks lend those deposits out we get another miracle -- "the creation of money out of thin air." So the Fed has been on an inflationary path, but it wants to mask the results of its activities. Gold tells the story; gold is the messenger, and believe me -- the Fed would love to kill the messenger.

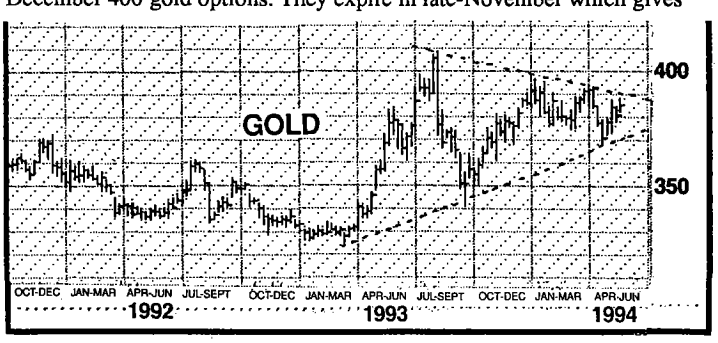


In the end, however, the truth will out, and the natural market forces will win. Gold will have its way as it always has throughout history. The long-term path of the dollar is down, which means that over time it will cost more dollars to buy an ounce of gold.

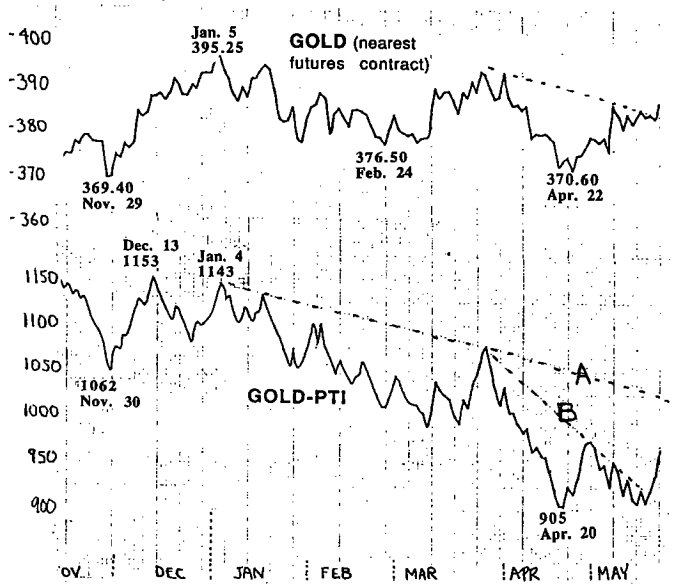
Nobody seems to have noticed it, but gold on the weekly chart has formed a large, clearly-defined triangle. At 370 or lower, the triangle breaks down. At 390 or higher, gold breaks out on the upside.

Now let's turn to my daily chart of gold and the Gold-PTI. On the daily chart a move by gold to **385** or better would represent a minor upside breakout. Meanwhile, the **Gold-PTI** has bettered trendline B, but for a more bullish indication, I'd like to see the G-PTI move above its last little peak at 975. A much more impressive move by the G-PTI would be a bettering of trendline A.

Final comments: OK, OK, I'm a derivative-monster -- I bought the December 400 gold options. They expire in late-November which gives



NEXT MAILING: June 8, 1994



me almost six months for gold to move "into the money" or above 400. However, the options are not cheap, selling for just under $1200 each.

Silver: Worldwide fabrication demand for silver outpaced supply for the fourth consecutive year in 1993 -- by a record 207 million troy ounces. The deficit is forecast to widen this year to 248 mil. ounces. Remember those rumors that "the new photography would outmode silver." Never happened, did it! Let's watch silver, "the poor man's gold."

LATE NOTES: In April the FOREX traders hit the dollar hard, and we saw massive intervention by 17 central banks including our own Fed. Will the FOREX bunch give up after only one intervention? Maybe, but I doubt it. They know that a renewed attack on the dollar would find the Fed "over a barrel" -- on the one hand very reluctant to defend the dollar with another rate boost. On the other hand, if the Fed does raise rates again that would kill the bond market and the economy, and the dollar would head down anyway. Ah, "catch 22."

The commodities are really popping now. Fear of a Mid-West dry spell is sending the grains skyward, and copper and coffee have gone off the charts (on the upside). CRB Futures Index today (May. 23) at a three-and-a-half year high! To Alan Greenspan -- you wanted the job, didn't you -- listen, nobody promised you a rose garden.

How weak is the dollar? Since 1955 the dollar has lost 55% of its value against the yen. And recently, the weak dollar has pushed the yen up to near-record highs (a move which obviously worries the Japanese). Since January '93 the Japanese government has mounted the greatest concerted wave of market intervention in memory, spending over $35 billion to buy dollars and thus hold back the rise of the yen. Despite this, the latest bilateral figures show that Japan's trade surplus with the US surged to $5.8 billion in March, third largest deficit on record.

Stock market: Have you noticed how many days we've seen divergence in the Averages (Dow up, Transports down or vice versa). When the Averages "disagree," it is often a sign of distribution. I can't remember the last time the Averages have disagreed to this extent.

I can't help commenting on the cover story in the June issue of *Money* magazine. In blaring red letters, they shout, "Buy Stocks Now!" They may be right, but personally if I were *Money* I'd be just a mite more cautious.

On any test of values the Dow is super-expensive, selling at an outlandish 37-plus times its $101.01 dividend, and this in the face of a bearishly rising trend in interest rates.

Nevertheless, if you glance at any publication from a brokerage letter to the *WSJ*, what you'll see is an endless list of stocks to buy. Despite the fact that a slew of stocks have already been battered down 20% to 50%, it's "buy, buy, buy, and more buy." Wall Street doesn't make a living when its customers are sitting on the sidelines in cash. No, Wall Street makes its living by selling and distributing stocks and bonds.

Note: We've changed the Low-Risk Index on the Dow from monthly to weekly. We've found that the weekly Low-Risk statistics are more sensitive and all around more useful for calling bottoms. Please adjust your statistics accordingly.